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Sisson, Francis Hinckley

The effect of the war on railroad securities address

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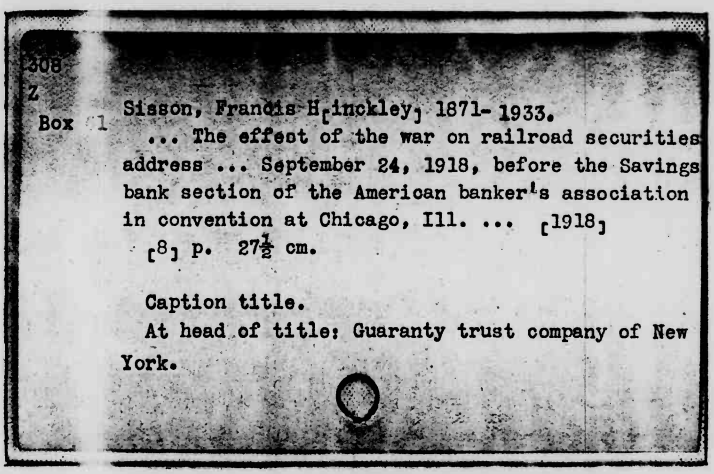
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SEP 28 1918

Guaranty Trust Company of New York
140 Broadway, New York

The Effect of the War on Railroad Securities

Box 308 Z Box 61

ADDRESS

by Francis H. Sisson, Vice-President of the Guaranty Trust Company of New York, September 24, 1918, before the Savings Bank Section of The American Banker's Association in convention at Chicago, Ill.

WE have passed logically in our consideration of the world war, from war causes to war effects and prospects. In the midst of the pressing problems in every line and interest which the war has so materially affected, we no longer ask *why?*—but *what?* So we, as bankers, as large holders of securities, and as trustees for others in their holdings, may pertinently make inquiry to-day as to the effect of the war upon railroad securities, and their possible future.

I conceive that it was not the intention of your Secretary in asking for a discussion of this subject, either to review the past, or to chronicle the present, which is written in the daily market records, but rather, if possible, to analyze and consider the trend of railroad security values in the light of the changed conditions which the war has precipitated.

The Public Interest

The questions of the moment in the minds of all, are: Will railroad securities rise or fall under these changed conditions? Will Federal administration of the railroads improve or injure their status as economic factors? Will private or public ownership follow the present anomalous situation? Can the present merger ever be "unscrambled"? He would indeed be a prophet who could supply the answers; but one may at least have the temerity to speculate on these subjects and enjoy the diversion of discounting the future mentally, if not market-wise, without criticism.

The fact need hardly be emphasized that the probable future course of railroad securities is of most vital interest to bankers, to investors, and to the general public. Railroad securities make up a considerable part of the assets of banks, particularly savings banks, life insurance companies, and trust estates. The extent to which the public is interested in the position of railroad securities is indicated from the fact that more than 600,000 individuals own the capital stock of American railways, and perhaps 300,000 hold their bonds. More than 11,000,000 citizens of the United States deposit their savings in the savings banks of the country, the security for whose investments rests to a degree in railroad bonds, while more than 34,000,000 life insurance policy holders in this country depend in a measure upon railroad bond investments as security for their premiums and policies, and consequently are vitally interested in their earnings and prosperity.

Official reports to the Comptroller of Currency in 1917 showed that the National banks of the United States held about $500,000,000 of railroad bonds, and that State banks, savings banks and trust companies held approximately $1,500,000,000 of such securities.

The Comptroller, in a letter to the Interstate Commerce Commission on November 1, 1917, stated:

"These investments the banks purchased in the belief that they would maintain the prices at which they were purchased, or grow more valuable from year to year, with the growth and development of the country's business and of the corporations issuing them. A crisis, however, has arisen. There has been a serious collapse in the market values of railway securities and such a demoralization of credit that the sale of new securities to provide fresh capital or to meet maturing bonds has been shut off, and even temporary financing is now only being obtained at rates which are costly if not ruinous.

"The impairment of confidence and the consequent shrinkage in securities," the Comptroller continued, "had become so pronounced that on October 15, 1917, I gave to the press a statement which said, in part:

" 'In view of all conditions, the Comptroller of Currency has instructed National banks holding high grade bonds of unquestioned intrinsic value and merit, not to charge such investments down to present abnormal figures; but an intelligent and conservative discretion will be exercised as to the prices at which National banks can safely and reasonably be permitted to carry such high class securities, and as to what proportion of the depreciation should be charged off in any six months' period.' "

Savings Banks' Holdings

The importance of this ruling appears when the fact is considered that in those States where the investments of the savings banks in railroad bonds

are segregated in the reports made by State banking institutions, there were on June 20, 1917, $339,755,-255 of such holdings, amounting to 53% of total investments.

Applying the foregoing ratio to the total number of savings banks in the United States, the aggregate value of railroad bonds held by such institutions would appear to be $1,214,319,000, or a little more than 20 per cent. of their combined resources.

And if the same ratio be applied to the total investments of the State banks, the amount of railroad bonds held by them would appear to be $472,000,000, which added to the $1,214,000,000 held by the savings banks, would give a grand total of $1,686,000,000 for both State and savings banks, as compared with the Comptroller of Currency's round figure of $1,500,000,000.

Loss of Public Confidence

For nearly forty years after the Civil War the surplus earnings of the people of this country which were put into public securities were largely invested in railroad bonds and stocks, and this enabled the railroad net to expand from 52,922 miles in 1870 to 192,940 miles in 1900, or nearly 400 per cent. But during the period between 1892 and 1897, when 213 roads, with a combined mileage of 56,402 miles, went into the hands of receivers, the investing public lost confidence in railway securities.

"The records show," to quote again from the letter of the Comptroller of Currency, "that the persistent and steady decline in railroad freight rates which had been going on through several decades culminated in 1898-9, but this shrinkage did not cease until the solvency of over one-half of the entire railroad mileage of the country which had been built up to that time had been destroyed."

From an average freight rate of 10.01 mills per ton per mile in 1888, there was a gradual and steady decline to 7.24 mills per ton per mile in the fiscal year of 1898-9. During the same period there was a reduction of 18 per cent. in the average passenger-mile rate. And coincident with these reductions, companies operating thousands of miles of rails were forced into bankruptcy. Fortunately, in 1899, general business throughout the country began to prosper again, and with it was initiated the upward trend of railroad finances and a revival of confidence in railway securities. This condition prevailed and steadily improved until the financial panic of 1907, with a subsequent stretch of years of uncertainty.

A striking presentation of what the shrinkage in the value of the common stock of the twelve leading railroad systems from the high prices in 1906 to the low level at the close of 1917 has meant is afforded by the fact that that decrease amounted to $1,690,000,000, or 51.50 per cent. This sum is nearly as great as the entire capital and surplus of all the National banks of the United States.

Government Regulation

The restrictive policy pursued toward the railroads by Government agencies, both National and State, for the last ten years, which operated both to limit earnings and increase expenses, could serve only to injure railway credit, and impair the confidence of investors in that field. Multiple regulation, political imposition, and a constantly increasing tax burden brought the railroads to the point where it was no longer possible to finance their requirements with stock, and the constant enlargement of their debt and a consequent increase of fixed charges were forced upon them. With approximately $17,000,000,000 of securities outstanding, about $11,000,000,000 was represented in bonds and $6,000,000,000 in stock, a proportion of debt becoming increasingly too large to assure adequate protection to the investor.

In the fall of 1915, when there was a large mileage in receivers' hands, and retrenchment of railroad operations was at its height, there came an avalanche of new business. The huge munitions manufacturing industry which had sprung up required great quantities of supplies, of which the railways are large consumers. There also developed a heavy foreign demand for American railway equipment and supplies. In consequence prices soared, and it became impossible to get equipment without long delays. The shortage in ocean shipping, further added to the difficulty by producing acute terminal congestion.

On April 1, 1917, the car shortage was the largest ever known. Five days later Congress declared war. This meant in addition to the large business with which the roads were already overwhelmed, that they were confronted with a large amount of military business which, of course, was given preference, and this increased the difficulty of getting the maximum usefulness of transportation facilities, which had been curtailed and impaired without regard to the nation's economic welfare, by reduced rates, rising costs of material and labor, and by political domination.

Mr. McAdoo, as Director General of the Railroads, recently well described the situation which the nation faced, in the following statement:

"Last December the expenses of the railroads were increasing with great rapidity. They were hedged about in their efforts to obtain increased rates by the numerous and various restrictions imposed by the States and also by the limitations imposed by the Interstate Commerce Act.

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They were confronted by imperative demands for greatly increased wages, and were without machinery to insure an amicable settlement of these demands. They were finding it almost impossible to borrow money on any terms to make the improvements which were indispensable to enable them to perform their public service."

To meet this situation the railroads, by Act of Congress, and in accordance with the terms of the contract now approved by the Federal authorities, were taken over by the Government under the guarantee of a standard net income averaging that for the three years prior to Government operation.

Satisfying Investors

Describing this arrangement Mr. McAdoo says:

"Under Federal control the Railroads have the opportunity to contract with the Government for a guaranteed income on a just basis, which relieves them of the formidable anxieties which confronted them in December, and which would still be confronting them under private control. They are able to borrow money from the Government on reasonable terms for necessary improvements. These are fundamental things which impress the great body of railroad investors, and should make them satisfied with the status as it now exists."

While the form of contract finally offered the railroads is not entirely satisfactory to the owners of securities it appears, that it is the real intention of the Railroad Administration to assure a return to the individual companies which will enable them to pay their fixed charges, interest, taxes, sinking funds, etc., and also regular dividends where justified, and to invest their surplus earnings in their properties under conditions which will increase their earning capacity and value. Furthermore, it appears to be the intention of the Railroad Administration, so far as industrial and labor conditions will permit, to maintain the physical properties adequately, and in case of failure to do so, to pay the companies enough to offset the deferred maintenance. A great deal of latitude is left to the authorities in the interpretation and execution of the contract, but there is every reason to believe that this will be fairly made, and the security holders' interest will not suffer seriously thereby.

This contract has been generally approved by the Railway Executives and their counsel, and formal announcement to that effect has been made public through their Advisory Committee representing more than 90 per cent. of the important lines of the country. It will doubtless be executed as it now stands by most of the lines. This approval was regarded as a warrant for an improvement in the railroad security market, and, as the likelihood of harmonious agreement increases between the owners and the Federal Administration, a greater improvement, subject to other conditions, should follow.

Security Prices

It is interesting to note, however, that on December 26, 1917, just prior to the Government assuming control of the railroads, ten of the highest grade railroad bonds were quoted at 81.40. On December 28, just after the Government took over the roads, these bonds stood at 81.94. On July 1, 1918, they were 81.17; on September 3, 81.11, and on September 6, 80.66.

Ten representative second grade railroad bonds were worth 75.79 on December 26, and two days later—following the taking over of the rails by the Federal authorities—they had risen to 77.15. On July 1, 1918, they were worth 78.05, on September 3, 77.87, and on September 6, 77.60.

During the same period, namely, December 26, 1917, to September 6, 1918, inclusive, ten representative high grade industrial bonds had advanced from 89.42 to 91.86, and ten representative public utility bonds had declined from 82.14 to 80.70.

On the other hand, the average price of twenty representative railroad stocks rose from 71.61 on December 26, 1917, to 86.93 on September 3, 1918, an increase of 21 per cent., and stood at 85.55 on September 6. How far Government control alone was responsible for this advance, it is impossible to determine. That other factors at least entered into the situation seems assured when it is noted that the average price of twenty representative industrial stocks likewise rose in value, from 68.33 to December 26, 1917, to 83.48 on September 3, an increase of 22 per cent.

The Future Problem

The future value of railroad securities will not be determined, even during the period of Government operation, and still less in the period of transition from Government back to private operation, by the compensation which the Government may pay the companies, or by the way in which it may maintain the properties. As the prospect of the return of the railways to their owners as the act contemplates, becomes more imminent, the ratio between earnings and expenses will become a more and more important factor in determining the value of the securities.

It seems reasonably certain that after the contract has finally been executed by the roads, railroad stocks will be placed in about the same class as railroad bonds, since, with their earnings definitely limited and guaranteed, speculative possibilities will

be largely eliminated from them and their prices should not greatly fluctuate.

From the short term viewpoint, that of the period of Government regulation, the position of the security holder is fairly definite. He has assured for him a definite guaranteed return and need not be disturbed about the uncertainties that might arise during this period. He has thus been greatly served by Government intervention.

However, it is clear that Government operation will undoubtedly make it very difficult for some roads to have returned to them the same kind of a railroad that they had before the Government took over its operation. Through the re-routing of traffic and the common use of terminals the business that certain roads had developed will be affected, and they have insisted upon their right to recover damages for such losses, in order to protect the interests of their security holders.

Results of Government Operation

It is still too early to determine the full results of Government operation, but operating revenues for the six months ending June 30, show an increase of nearly $200,000,000 over the first six months of 1917. Operating expenses, however, were nearly $500,000,000 greater showing an operating deficit of nearly $300,000,000 for this period.

The net amount which the Government received from the railroads for these six months was approximately $151,000,000. In return the Government is liable to the railroads for about $475,000,000, or one half of the $950,000,000 estimated as the aggregate guaranteed return. Reduced to percentages, the operating ratio for the railroads of the country for this period was about 110 per cent., or in simpler terms,—for every $100 received from operation, $110 were spent in operating expenses.

What the future of such expensive operation would be on railroads and railroad security values, without Government support, can readily be imagined. It is fair to state that this period included the increased costs of wages and materials, without the commensurate return promised by higher freight and passenger rates, which will be enjoyed during the balance of the year.

The relatively slight economies which have so far been affected by unified operation have been negligible in the face of increased costs. In these respects the contentions of the Railway executives before the Interstate Commerce Commission have been more than justified.

Some of the public statements in regard to economies effected under Federal administration give the impression of "straining at gnats and swallowing camels." After much talk about reducing the salaries of high-priced officials, a petty saving of $4,600,000 has been effected, which, in the face of increased wages granted, is hardly an item. The pooling of passenger offices, the elimination of advertising, the reduction of passenger service, have effected relatively negligible savings, not to mention the petty, but no doubt politically important, stoppage of private cars.

The simple fact of record is that the greatest savings which the railways effected under private management were made by increasing the average trainload. The average trainload increased from 574 tons in 1915 to 610 tons in 1916, and to 649 tons in 1917. The increase in 1916 over 1915 was 36 tons, and the increase in 1917 over 1916 was 39 tons. No such increase in the tons per train-mile has been secured under Government operation. In the first six months of 1918 the average tons per train was 653, an increase over the corresponding period of 1917 of only 14 tons. In the month of June, 1918, the latest month for which we have official figures, the average number of tons per train was 698, which was exactly the same as it was in the month of June, 1917.

Income and Outgo

On the whole, it would appear that the advances in rates which have been made will be no more than sufficient to cover the increases in operating expenses, and that, therefore, after paying operating expenses the Government will not have much more net return than will be required to pay the standard return to the companies. It would appear, therefore, that, in the absence of further advances in rates, the margin between railway earnings and expenses during the period of Government control will not be sufficient to cause any considerable effect upon the value of railway securities. It must be assumed that a large part, if not all, of the advances in expenses which have occurred under Government control, and in the period immediately before Government control was adopted, will continue for a long period after the railways are returned to private management.

It obviously follows that if railroad securities are to be adequately protected we must look forward to a continuance of rates, freight and passenger, upon the present basis for an indefinite time after the railways are returned to private management.

The question of rates has been in the past the very heart of the railroad problem, and if the railways are to be returned to private management it will be the heart of the railroad problem in the future. It

may be flatly stated that the decline in the value of railway securities in the past has been chiefly due to the refusal of the Interstate Commerce Commission and other regulating bodies to permit the railways to charge adequate rates, and, under private management of the roads, the value of railway securities cannot be maintained in the future unless the Commission will allow the companies to charge adequate rates.

For years before Government control was adopted the companies were pleading for higher rates, but their appeals in the main were futile. The action of the Government within a few months after it assumed the operation of the railways in advancing their passenger rates 50 per cent. and their freight rates 25 per cent. was a confession that the past policy of the State and National Governments in regulating rates was inexpedient and unjust, and it can hardly be assumed that the Government, after having thus conceded that its past policy was wrong, will return to the same policy after the railway companies have been restored to the management of their owners.

The Government's Guarantee

Investors have generally assumed, that the Government's guarantee of compensation will be fulfilled in good faith, and that the entrance of the Government into the transportation field foreshadows the solution of its problem on some basis which will be equitable to them. This assurance certainly seems warranted as the Government has recognized and expressed both in respect to the legislation and also the contract formulated in pursuance of it, both the justice and the importance of according to owners of railroad securities the protection to which they are justly entitled.

President Wilson in taking control of the railroads issued a statement to the public in which he said: "Investors in railway securities may rest assured that their rights and interests will be as scrupulously looked after by the Government as they could be by the directors of the several railway systems."

Admitting that a fair contract has been worked out, and that the immediate future is assured we still face the problem of what is then to follow in the reconstructing of our railway system. The public and the railway security owners both have much to gain from a more satisfactory solution of the railway problem which will retain all of the advantages of coördination and also of individual ownership.

Three Possible Solutions

While it is now definitely planned to turn the railroads back to the individual companies at the end of Government operation which may continue for a term of 21 months after the war, it is quite probable that before that time conditions may arise for a complete modification of this program, and for that reason it is well to point out various possibilities in which that program might be modified.

There are three ways in which the railway system of the country can be handled at the end of Government operation. The first is the present plan of returning the roads to their individual companies; the second is that providing for complete Government ownership, and operation, while a third plan is possible, that of modifying the old system of individual companies into one of regional railways under private ownership which will insure all of the advantages that would come from a coördination of railway facilities and the advantages that would come from retaining private ownership and private enterprise in the management of the roads with Government coöperation and guaranty. The security holder is vitally interested in all of these possible solutions, and the future of railway securities is dependent upon the course taken.

Waste Under Competition

In seeking the most satisfactory solution, both to the public and the security holders, it should be borne in mind that the history of the development of the railways of this country shows clearly that the public, the Government and the railway owners have taken a wrong viewpoint relative to the transportation problem. It has been insisted that the railway business, like any other private business, must be developed along competitive lines. And it must be recognized that perhaps historically this principle has been of considerable value in securing an early development of railroad facilities, perhaps an earlier development than might have been possible under any other system. But it is evident that this has led in many instances to an uneconomic utilization of capital.

In the first place, this competitive policy has led to needless duplication of trunk lines, and in some instances these trunk lines were constructed merely as "threat" roads in competition with some already established railways. From a social viewpoint this led to a waste of capital. In the case of terminals the competitive system has led to further waste. In some instances the cost of entrance for a competing road has been larger than that of constructing modern unified terminal facilities for all the roads entering that particular city. A continuation of the competitive system would lead to a further duplication of terminal facilities, and prevent the public securing the advantages that might come from unification.

Ecomonic Operation of Railways is Dependent on a Natural Monopoly

Transportation is not naturally a competitive business, and it has been a great mistake to consider it as such. The railway, in furnishing transportation, is simply creating place utility, or what is equivalent to the same thing, is modifying advantages that may come from particular locations.

The business of any railroad is largely dependent upon the industrial and economic life of its territory. The railway may lead the way for the development of its territory by extending new lines out into undeveloped areas, and by encouraging the location of industry along these lines through favorable rates and favorable railroad facilities. The general economic development of its territory ought to determine the standard of service that any particular railroad should give.

A regional railroad system based on natural traffic divisions would meet the tests of economic operation and of economic utilization of railway capital. In the development of such a system we should be able to retain all the advantages that come from individual ownership and operation, to retain the advantages that would come from coördination of railway facilities under Government ownership and operation, and at the same time avoid the evils that would undoubtedly develop from either Government ownership, or a continuation of the old competitive system. It would lay a sound basis for the development of a wholesome territorial competition in industry, supervised by regional commissions acting as regulating bodies under one central commission.

Ownership

It should be planned to have the ownership of these companies under Federal incorporation rest in the hands of individual holders who at the time of transfer would represent the owners of the existing railway system. In taking over existing securities of the railways, and in consolidating them with the regional system, a broad viewpoint of value based on fair, average market prices should be taken. In any plan of reconstructing our railways it must be assumed that the rights and equities of the present holder of railway securities will be recognized. In effecting the exchange of securities a Government commission should take cognizance of these claims and make proper adjustments for them. Some plan providing for guaranteed dividends and a profit-sharing arrangement with the Government above the guarantee, together with Government representation on directorates would cement public and private interests in this consolidated enterprise.

Insofar as the regional road would lead to an economic use of capital and thereby eliminate the wastes under the competitive system, the equity back of the various railroad securities should increase over a period of time. The development of a rate structure for each regional railroad on the basis that rates should be high enough to assure the proper standard of service, should improve the earning position of the road. Placing railroad credit upon its proper basis, that of the industrial and economic needs of its territory, provides the soundest basis for security values.

Factors Affecting Railway Credit

If it proves impossible to reduce labor costs on the return of peace, particularly when the time is reached, as it must be reached, for an efficient economic readjustment and the consequent reduction in operating revenues, the position of the railway security holder would not be satisfactory if the roads are returned to their competitive conditions. Their future would be dependent entirely upon the breadth and courage shown by the Interstate Commerce Commission and the State commissions in adjusting rates from time to time so as to show a fair return and adequate protection to the security holder. Because it is doubtful whether the Interstate Commerce Commission would take this broad viewpoint on returning the roads to competitive conditions, it seems necessary to advocate some coöperative plan and the enactment of such legislation as would create an entirely different attitude on the part of the Government and the public towards the regulation of our railways.

Outside Influences

Economic factors entirely outside the field of transportation, of course, will also affect railroad security values in the future and must be reckoned with. The higher cost of living, the depreciated purchasing power of the dollar, the level of interest rates, and the increasing burdens of taxation will all tend to emphasize the desirability and perhaps the necessity for higher yields. This situation would seem to indicate a greater demand for junior securities and second-rate bonds, and a consequently lesser demand for the higher grade issues. Higher values for the former, and lower values for the latter would then follow, because with the Government's guarantee to assure interest payments, the quality of the security behind the obligation will temporarily not seem so important as before.

It would be a mistake for investors to regard too seriously current earning statements of any railroad property, as under Government operation these may not reflect the real earning power of the property accurately. Past earning records and the Government's guarantee to the separate lines form the only sound basis of figuring present value.

Under the Government's contract dividends are left subject to some uncertainty in the right of the

Director General to order the roads to expend money from their compensation, if they cannot get it from other sources, to pay for improvements or maintenance in excess of what they have spent. This power is declared in the contract to be an emergency power and there is a stipulation that it will be the policy of the Director General not to exercise it in such a way as to interrupt unnecessarily the payment of regular dividends, but it creates a doubt which will undoubtedly make it impossible to do any financing through stock issues and, therefore, will tend to increase the proportion of capitalization bearing fixed charges. While the more prosperous roads that had large surpluses over dividend requirements may not be affected, the dividends of those roads which were just able to pay a dividend without much of any surplus will naturally be made more uncertain. The Government's attitude towards the security holders as evidenced in its administration of their properties will affect the public attitude toward railroad security values. If there is an evident desire to protect these values and to safeguard the properties upon which they are based, so that public confidence is inspired, sustained and possibly appreciated values may be anticipated.

Railway financing has been practically at a standstill this year and pressing obligations have been met with advances by the Government, which from April 1 to September 1 amounted to $241,000,000, together with various short term note issues.

If the practice of financing by the issue of short term or demand notes is continued, instability of the railroad financial structure must result even though payment of the notes is not demanded during Federal control. The situation resulting from the accumulation of a vast floating, or short term, debt maturing at the end of Federal control, or shortly thereafter, would be dangerous. Even if long term mortgage bonds are ultimately accepted by the Director General for these expenditures, that would only serve to perpetuate and exaggerate the already excessive proportion of debt in the railroad financial structure.

A further feature in the situation is the fact that these expenditures represent capitalization by debt of heavy expenditures at war prices. The standard contract expressly forbids the carriers to make any claim for loss at the end of Federal control on account of these high prices. This would be relieved if the Director General would authorize very liberal depreciation charges to operating expenses during Federal control so as to amortize the excess cost or at least the greater part of it before the roads are turned back to their owners. The propriety of such charges is recognized by the Government in computing costs under munition and other contracts and in figuring war taxes.

The Shippers' Attitude

Still other important factors will enter into the future of the railroads. The shippers of the country must determine whether they will continue to be "penny wise and pound foolish." Their long continued fight against fair rates was largely instrumental in bringing the railroads to the situation they faced last winter. Will they continue to be blind to their real interests, and by refusing to pay a living wage to the carriers, compel their retention by the Government, and thus impair their own interests?

Will labor be satisfied with its fair share of the railroad dollar, or will labor, by organized power, make private ownership impossible, and compel the Government to keep open these arteries of commerce?

It seems very certain that there must be either a radical change in the public attitude toward the railroads, a change which will invite the confidence of investors and make possible the efficient and proper operation under private ownership and direction, or there must be continued Government interference.

It may be stated without reserve, that the private owners of these properties cannot take them back on the old terms. In spite of the fact that the public will in many respects be inconvenienced, there is every reason to believe that ultimately Federal administration of the roads will be successful. Its freedom from restrictions, its extraordinary powers, together with patriotic support, should insure popular success, but, be it not forgotten, at high cost and at the sacrifice of much that has been deemed essential in service and operation.

The Government's Attitude

The expressed tendency on the part of the Federal Railroad Administration to take unto itself unction for having *saved* the railroads would be more convincing if it did not seem to ignore fundamental facts in the situation. For the spectacle afforded the public is simply that of one Government agency priding itself upon its part in saving our transportation system from a disaster which other Government agencies forced upon it! Moreover, it is priding itself upon its work in effecting economies through the elimination of competition, the pooling of operation, and the removal of State interference, together with the raising of rates, all of which steps had been strenuously advocated by the railroads themselves for years, and through political agencies denied. The assumption of any superior wisdom or merit by the Federal Administration for undertaking through the power given it the reforms which students of transportation have advocated for a decade is hardly warranted.

The regrettable, but inescapable fact is that it required the exigencies of war to make possible an economic rather than a political treatment of transportation. What the future attitude of the American people toward this problem will be, only the American people can say, but we may at least venture the hope that some progress in the public's education will have been made, with experience as a teacher, and that a more sympathetic understanding of the problem and its meaning in our business life may follow, as a basis for future constructive effort. The question of who shall solve the problem, and how, rests with the people. It is for them to say whether it shall be the business man, the statesman or the politician.

The Basis of Value

If Government ownership is inevitable, then the basis of value upon which this ownership is effected becomes of major importance. There are many ways in which this might be effected. Instead of absorbing the entire 17 billions of dollars of railroad securities the Government might be satisfied to leave the bonds outstanding in private hands, and merely absorb the stock. If the Government should be disposed to allow the owners of the railroads a compensation based on a fair capitalization of their estimated rental value of approximately $950,000,000 a year, security owners would receive a fair return for their holdings. It is certain, however, that before such an agreement could be made there would be much opposition and many theories of valuation would be advanced—for the most part entirely unfair to the owners.

If the Government buys the roads, the fact must be faced that decisions of the Interstate Commerce Commission indicate that its estimates would deprive the companies of many elements of value which they believe rightfully belong to them in any exchange. The contention has been made before the Commission that no allowance should be made for the important element of good-will, for appreciation in real estate values, or even for investments made out of earnings. The importance of this last mentioned item may be realized, when the fact is borne in mind that the Pennsylvania Railroad alone has put back into its properties more than $200,000,000 out of earnings, representing actual invested value.

It seems unthinkable that any such theories could ultimately prevail, and we have a right to assume that if the Government buys the railroads, it will be on a basis which will not cause confiscation of railway security values. Either through an agreement between the parties as to the purchase price, or as a result of condemnation proceedings, some mutually equitable basis should be possible. Nor need we take seriously the apprehension of some that the Government may allow the railways to deteriorate in order to buy them at a depreciated value.

In facing these contingencies the fact should ever be borne in mind that in no country has Government ownership of railroads been successful, with the single, possible, exception of Germany, where under military rule it has achieved some degree of efficiency; yet not even there has it produced any marked improvement in initiative or progress in methods such as have marked private ownership.

The railroads of the United States have served their public at the lowest cost, the lowest capitalization, and with the greatest efficiency of any railroads in the world. There has been nothing whatever in our experience with public ownership in this country to justify the assumption that it can be profitably assumed under normal conditions in the field of transportation.

It is sincerely to be hoped that there may come a larger degree of appreciation of the meaning of transportation in the life of our people, and of the high importance of its fair and constructive treatment. The ambitions of politicians seeking an issue, the selfishness of shippers fighting to save dimes and losing dollars, the prejudices of theorists, —the mistakes of the past, and the animosities of the present should not be allowed to interfere with the solution of the problem in the public interest. The public stake in this situation is greater even than that of the investor, and unless railroad investments are protected by the public, the public, itself, will be the greatest sufferer. The need of the hour is sympathetic understanding. Upon that basis alone can a sound future be built for our railways, and upon a sound transportation system alone can we build a sound and prosperous economic life.

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